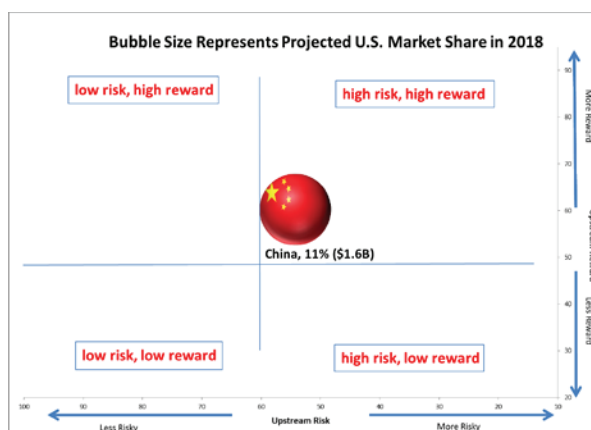


China

Overall Rank: 9

Type: Large Market; Small Market Share

In 2013, global O&G equipment imports into China were valued at roughly \$3.6 billion. Major new development areas in China's O&G sector are offshore and unconventional gas. China is seeking to increase the use of natural gas for power production and industrial usage, focusing gas development policies on unconventional resources such as coal-bed methane and shale gas. Despite the government's political directives, regulatory uncertainty and uncompetitive policies limit foreign participation.



In 2013, the United States exported \$670 million of O&G field equipment to China, our third largest trading partner and representing about 5 percent of our China-bound U.S. exports that year. Currently, top U.S. O&G equipment exports are parts for derricks and for sinking and boring machinery, which represent 28 and 53 percent of O&G exports to China, respectively.

Of O&G field equipment it imports, China ranked as the tenth largest market in 2013, valued at roughly \$3.6 billion. Chinese imports of these products grew about 10 percent from 2012 but totals remain lower in absolute terms than the \$5 billion imported in 2008. Over 70 percent of the 2013 imports were parts for derricks and sinking and boring equipment. China's top three trading partners in this segment were Korea, Japan, and the United States.

Policy Context: Challenges and Opportunities

China is the largest energy consumer and producer in the world, and its fast-growing economy places energy issues among Chinese policymakers' top concerns. As China pushes to meet its energy demand, the environmental costs of energy consumption—such as pollution from coal-power generation and transportation—have also accelerated China's search for new and cleaner forms of energy, particularly natural gas. In this respect, Beijing has announced ambitious targets for natural gas, stating this energy source must supply 8 percent of all energy demand by 2015 and 10 percent of demand by 2020. In 2012,

natural gas supplied 3 percent of China's power production.

In addition to building LNG import and pipeline infrastructure, Beijing is pushing to increase domestic natural gas production. Shale resource development is targeted for development because of its abundance and its success in the United States. According to US Energy Information Administration, China's technically recoverable shale gas reserves are 1,115 Tcf, the largest shale gas reserves in the world. China lags, however, in expertise and technology to develop these resources, and the government is incentivizing producers to increase investment and production. China's complex geology, however, means drilling is expensive, often over twice as expensive as in the United States.

The business environment for oil and gas development in China is challenging, particularly for foreign companies. Foreign participation in the China's shale initiative has been limited and state dominance, lack of competition, and uncertain regulations continue to frustrate international companies' efforts. Many winners of past bid rounds were domestic firms with little experience developing shale resources, which possibly opens avenues of cooperation for foreign oilfield service providers. However, regulations restrict competition and foreign participation. Nonetheless, ample subsidies, legal reform, and productivity targets are among the reasons production is expected to grow in the short-term with significant increases in the 2020s. Companies that specialize in drilling, extraction

equipment, pipeline construction or provide operational services for shale gas developers may benefit from the growth of the Chinese shale gas market. In addition, companies with expertise in deep extraction and water efficiency will also be well positioned as the market expands.

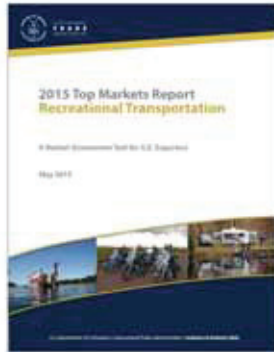
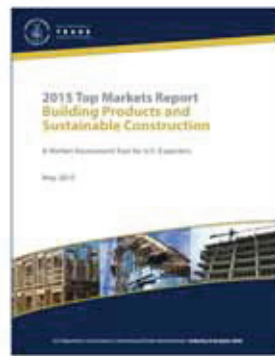
Deep-water resources, too, have a prominent place in Beijing's upstream growth strategy. More than half of the oil fields that provide about 80 percent of China's oil production are declining, and the country increasingly depends on imported O&G. To help reverse these declines, Beijing supports investments in technologies such as enhanced oil recovery and encourages the search for new supply through deep-water exploration. In particular, China's National Energy Administration (NEA) has stated that the South China Sea would 'form the main part' of the country's offshore exploration under the current five year plan. As a result, the domestic offshore support market is developing fast to cater to the needs of the Chinese offshore O&G industry.

International Oil Companies (IOCs) and service companies have established their presence in China chiefly through partnerships with Chinese companies.

In offshore development, IOCs mostly partner with state-owned CNOOC, while China's three largest state-owned firms for both onshore and offshore projects, which often involves complicated drillings, hire service companies. Offshore participation, however, carries risks because of China's expansive territorial claims. While some of China's offshore activity falls within recognized boundaries, conflicting claims with Indonesia, Japan, Malaysia, the Philippines, and Vietnam add operational uncertainty to future East and South China Sea exploration and production.

Recommendations for Export Strategies

China's is positioned in the high risk/high reward quadrant of the risk reward analysis and is also characterized as having small U.S. market share. There are a number of risks that U.S. O&G equipment and service suppliers face, specifically violations of intellectual property rights. U.S. companies are reluctant to bring their most advanced equipment to China, which has ramifications to increased development in China's O&G sector, most notably in unconventional and deepwater oil and gas extraction.



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